

Central Intelligence Agency



Washington, D.C. 20505

DDI #05630-85

14 November 1985

The Honorable George P. Shultz
The Secretary of State
Washington, D.C. 20520

Dear Mr. Secretary:

I want to follow-up on our brief conversation after the meeting with the President on Wednesday. You observed that a Soviet expenditure of 12-14% of GNP compared with about 6% for the United States means that the two countries are spending roughly the same amount of money on defense. However, the Soviets have been spending the same proportion of GNP on defense for nearly 20 years, have built great momentum into their programs, and between 1975 and 1980 the annual dollar value of Soviet defense activities exceeded US defense spending by 38-47%. With the President's defense program, that disparity narrowed, but even so the Soviets outspent us by about 15% even in 1983, the year of the highest growth in the President's program. [REDACTED]

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In describing Soviet military spending, I was alluding in my briefing to the much greater burden this imposes on Soviet society. It stands to reason, as you pointed out, that a society with an economy half the size of the US spending more than twice as much of its GNP on defense is going to pay an enormously heavy cost internally. It was the impact of this continuing burden on the Soviet economy as a whole to which I was referring. [REDACTED]

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As you said, even the figures cited above do not accurately capture the overall burden of defense for the USSR. For example, some key industries must devote especially large shares of their output to support defense programs. About 25% of all machinery production is allocated to military procurement even though procurement is no more than 7% of GNP. Moreover, the defense sector also has first call on the most talented scientists, engineers, managers, and other human talent in the Soviet system. All of these material and human resources are badly needed by the civilian sector to promote economic growth through investment or to bolster consumer morale by increasing the supply of consumer goods. Those sectors where the impact of defense is especially heavy -- high quality metals, precision machine tools, electronic components -- turn out the very resources the USSR

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must have if it is to successfully compete economically and technologically with the West. Yet, defense takes over half the output of these industries. [redacted]

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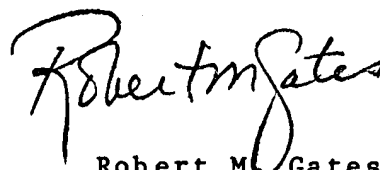
In short, if I understood you correctly, I do not believe there is any disagreement. The Soviets are not outspending us by 2 or 3 times but the proportion of their national wealth that they devote to defense is more than double that in the United States, and this in turn imposes very heavy costs on the Soviet economy and society. This was what I was citing as a weakness in the overall Soviet economic picture. [redacted]

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Just to respond to a technical point you raised on how we deal with personnel costs in trying to assess Soviet defense spending, we take that into account by using the pay structure appropriate to the currency being used. In rubles, that means we cost Soviet uniformed military personnel at the ruble rates of pay and allowances they actually receive. In dollars, we first estimate the military rank of the person in the United States who would perform the functions of each Soviet billet and then apply the US pay and allowance rates for that job. This procedure is consistent with the way we cost the other resource categories -- procurement, construction, and operations and maintenance. [redacted]

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Finally, I enclose a brief paper by our Soviet office that addresses the way we cost Soviet military programs. I appreciate your interest. [redacted]



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Robert M. Gates
Deputy Director for Intelligence

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The Cost of Soviet Military Programs

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Measuring the Soviet Defense Effort

Overall measures of the scale of the Soviet effort are important for judging the burden of defense on the Soviet economy and for comparing US and Soviet defense activities. Because of the difficulties in comparing so many different physical quantities (missiles, planes, men), one approach is to use money as a common denominator. Putting things in value terms generally takes account of both quality (better things usually cost more) and quantity. []

The Soviets publish only one defense figure, and that accounts for only a small fraction of total Soviet spending. Therefore, CIA estimates Soviet defense costs from the ground up in both dollar and ruble prices. Both measures aggregate all the men, weapons, and materiel in terms enabling us to compare the figures with other economic aggregates--e.g., the dollar value of defense spending in the United States or the USSR's own GNP in rubles. []

Costs are not a direct measure of military capability (for this one should look at how many weapons and military units of each type are deployed and how they are used). But costs do give a sense of the effort--in aggregate terms--that the USSR is devoting to its military forces. Over time, costs also show shifts in priorities--for instance, between offensive and defensive, tactical and strategic, or air and rocket forces. []

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Comparisons with US Defense Activities

The dollar costs of all Soviet defense activities are developed by identifying Soviet forces and their support elements. We make estimates for more than 1,000 defense components--for example, individual classes of surface ships, ground force divisions, and air regiments. The estimates take into account our latest estimates of the order of battle, manning levels, equipment inventories, and procurement for each of those components. To these detailed estimates of physical resources, we apply appropriate US prices and wage rates. For procurement--the largest single resource category--we estimate what it would cost to build the actual Soviet weapons and equipment in the United States at prevailing dollar prices for materials and labor, using US production technology. Costs of operations and maintenance, military personnel, and construction are estimated in a similar fashion; RDT&E is derived from Soviet statistics. []

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The Burden of Soviet Defense Spending

The ratio of defense spending to GNP represents the share of a nation's total product that is devoted to defense--a number that is often called the "burden of defense." Burden in the USSR must, of course, be measured in ruble terms--the actual cost to the Soviets. Even counting just those defense activities that would be included in a US defense budget, Soviet defense amounts to about 12-13 percent of GNP; the comparable ratio in the United

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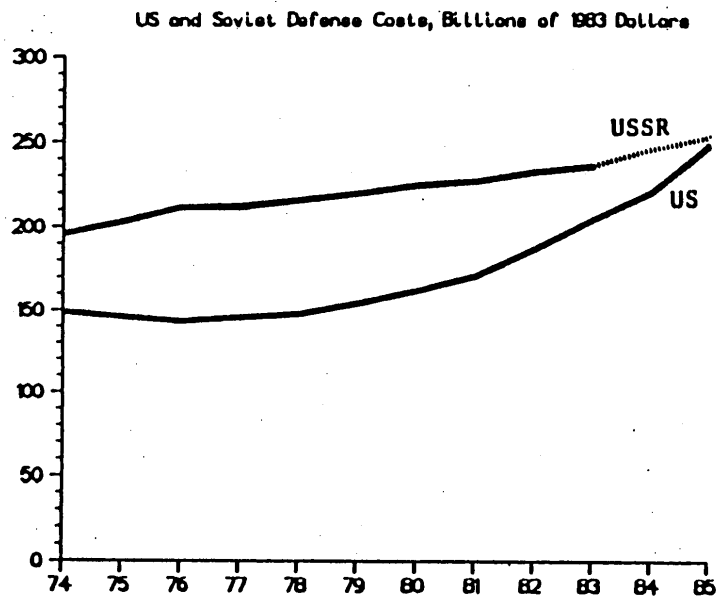
States, when the aggregates are expressed in dollars, is 6 percent. This share of defense in Soviet GNP has remained roughly constant since 1965 because the growth of defense spending has matched overall economic growth. These burden estimates, however, do not include other national security-related activities such as civil defense, stockpiling material reserves, maintaining surge capacity in industry, and supporting and subsidizing client states. Including such activities in a definition of defense would result in a higher burden for both countries. [REDACTED]

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The impact of defense clearly falls unevenly on different parts of the Soviet economy. Some key industries must devote especially large shares of their output to support defense programs. For example, about 25 percent of all machinery production is for the military even though military procurement is no more than 7 percent of GNP. These resources are badly needed by the civilian sector to promote economic growth through investment or to bolster civilian morale by increasing the supply of consumer goods. Those sectors where the impact of defense is especially heavy--high quality metals, precision machine tools, electronic components--turn out the very resources the USSR must have if it is to successfully compete economically and technologically with the West. Yet, defense takes over half the output of these industries. [REDACTED]

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Cumulative Costs, 1974-85

US		2075 Billion Dollars
USSR		2670 Billion Dollars

The Soviet dollar costs represent what it would cost, using prevailing US prices and wages, to produce and operate Soviet military forces. The dashed segment of our Soviet cost estimate signifies a lower confidence in our figures for these years. They are heavily influenced by projected weapons deployments and could change as we collect more information on Soviet activities. All costs are measured in